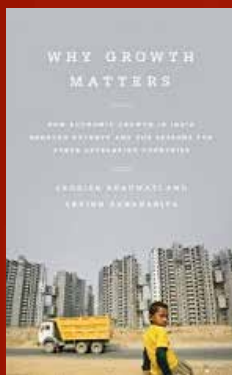


# INDIA: a recipe for GROWTH



**JAGDISH BHAGWATI** is one of the world's leading economists and an expert on trade, globalisation and the Indian economy.

He recently published *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries*, co-authored with Arvind Panagariya, which was picked as a 'best book' of 2013 by the Financial Times.

Bhagwati was also the fictional winner of the Nobel Prize in an episode of the Simpsons!

In this interview with IEA Editorial Director **PHILIP BOOTH**, Professor Bhagwati discusses the relationship between trade, economic reform, growth and poverty in India, while also clarifying, at the editor's request, Amartya Sen's critiques and arguing why they are misplaced...

**What does the empirical evidence suggest about the benefits of opening up trade for the world's poorest people?**

The argument about trade helping alleviate poverty is analytically based on two propositions: firstly, trade leads to growth; and, secondly, growth reduces poverty. In turn, the latter proposition can be broken down into two component causations which I developed over a quarter century ago in a lecture on poverty and public policy: (1) that growth pulls up the poor above the poverty line (making it an activist "pull up" rather than a passive "trickle down" process); and (2) it generates revenue that will enable governments to spend on areas such as health and education for the poor. Every one of these propositions is empirically testable, of course.



## DOES TRADE LEAD TO GROWTH? THAT IS CLEARLY OBSERVABLE

So, does trade lead to growth? That is clearly observable. But there are two obvious caveats. The trade opportunity has to be exploited or it does not lead to results. If you open the door but you have no traction in your legs, you will not go through the door. Also, we must ask whether such growth is sustainable. I once asked the trade-sceptic Dani Rodrik, who says that there are instances where autarky has also been associated with growth, whether growth associated with autarky was sustainable. My answer to this question is illustrated by the story of how Joan Robinson, my radical Cambridge tutor, and Gus Ranis of Yale University were once observed agreeing that Korean growth was a miracle, causing astonishment, until the audience realised that she was talking about North Korea and he was talking about South Korea! Now, of course, we know which Korean miracle was sustainable. Equally, in *The World Economy* Arvind Panagariya has analysed a lot of cross-country data and found strong correlations between high (low) economic growth and high (low) growth rates of exports. Of course, the causation can go from growth to exports; but is this really plausible except in special cases?

Next, as for growth affecting

poverty favourably, there is much empirical evidence to support that element of the argument as well. As Panagariya and I explain in *Why Growth Matters*, detailed country studies, such as for India, show that poverty was hardly dented during periods of little growth resulting from bad economic policies and then was reduced dramatically once growth took off after the 1991 reforms.

**What were the main reasons for India's poor growth performance and high levels of absolute poverty in the 45 years following independence?**

The low growth rates – total national income grew at roughly 3.5 per cent a year but population was growing at 2 per cent – came after India adopted a series of bad economic policies that crippled

the economy's efficiency. These bad policies were embraced with added vigour when Prime Minister Indira Gandhi came into power with the support of the left-wing Congressmen: a marriage of convenience turning into a bonding which turned into a kiss of death for the country.

**How did the 1991 reforms contribute to increasing economic growth in India?**

The pre-reforms policy framework consisted of the following key elements:

1. A senseless maze of controls: one thinks of course of Kafka but I once remarked more appropriately that India's problem was that Adam Smith's invisible hand was nowhere to be seen!
2. Massive proliferation of public enterprises which were grossly inefficient and loss-making. Once Amartya Sen defended them by arguing from familiar economic theory that the losses were compatible with social good, revealing that good policy sense means choosing an appropriate model to examine a problem. By contrast, John Kenneth Galbraith, who was US Ambassador in India at the time, showed acute

commonsense and policy grasp by describing the approach as “Post Office Socialism”.

3. Autarky in trade: the Indian share of trade in GNP, and share in world trade, had both fallen thanks to tariffs, quotas, import licensing etc. Again, the left-wing economists were supportive of such autarky and there is no evidence otherwise apart from unprovable assertions. For example, Amartya Sen says he “told Manmohan”, the prime minister now, that he supported liberalisation. But, why did he not write publicly and forcefully about it? After all, he is not shy otherwise.

4. A jaundiced view, and virtual rejection, of inward foreign direct investment (FDI); again there are quotable assertions by Amartya Sen and his colleague, the activist Jean Dreze, that Indians spend too much time considering whether Coca Cola should be allowed to invest and too little on discussing poverty, blissfully ignorant that FDI has often been a source of growth that led to poverty reduction. When the 1991 reforms started, the equity investment in India was as little as US\$100 million!

These “anti-growth” policies began to be swept away in 1991. It was, however, like cleaning up after a tsunami. And the task is not yet complete, as Panagariya and I explain in depth in our book.



## INDIA NEEDS LAND AND LABOUR-MARKET REFORM AND PRODUCT-MARKET DEREGULATION IN ORDER THAT MARKETS CAN DEVELOP THAT SERVE AND ENRICH THE POOR

*Is it the case, as some people suggest, that increased growth has not translated into improved living standards for the majority of India's poor?*

This is one of the many myths we destroy in Part I of our book. We cite empirical studies, some commissioned by us as part of a massive research project on such issues, that show that poverty has diminished since the reforms accelerated growth, and that the improvement in income extends to all marginalised groups such



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as women, scheduled tribes (ST), scheduled classes (SC) and Untouchables (Dalits). The studies by the noted political scientist Al Stepan also show that these groups are aware of their gains and also believe by a majority that their economic situation will continue to improve.

*What more needs to be done to reduce poverty in India still further?*

We have shown that growth in India has been “inclusive”. But we also argue that we have had less impact on poverty with our growth than the Far Eastern economies have. Among the central differences has been that India has not used labour-intensive industrialisation (which increases demand for labour) and has relied more on skill-intensive and capital-intensive industrialisation (which tends to reduce the gains in wages). India needs land and labour-market reform and product-market deregulation in order that markets can develop that serve and enrich the poor. This might include, for

frank about their assertions in our book. As I sometimes say, their conclusions are more obvious than their arguments. It is noteworthy that Amartya Sen, who is certainly a fine economist when he sticks to theory, has appropriated the phrase that Indians are “argumentative” (which I used in a very different context some time ago to suggest that Indo-US relations were strained because Indians argued back with aid-dispensing Americans who were then offended) to suggest, astonishingly, that today's India is a Habermasian democracy. At the same time, he has refused to debate me on the economic arguments in the recent Bhagwati-Panagariya book: some argumentative Indian!

*How would you characterise the differences between your own position and that of Amartya Sen, who has also participated in debates about economic reform in India?*

Sen has made ex cathedra criticisms, but, as I stated above, he avoids a debate, telling journalists that “Jagdish wants to debate me but I do not want to debate him”! I have written an epitaph for a debate that was not!

I have already indicated above that Sen was opposed, or failed to endorse wholeheartedly, nearly all the reforms that started dramatically in 1991 and which increased the growth rate and reduced poverty. Despite belated assertions to the contrary, he has produced no evidence whatsoever that he was in favour of the 1991 reforms. So I have argued bluntly that in this instance his sin with regard to reducing poverty was one of omission.

Now, he wants to make up for this by asking for more money to be spent on health and education and employment guarantee schemes. But where is the money to come from, if not from growth? As the present government plans to increase such spending while the revenue intake is slowing down with sluggish growth, Sen is in the position of supporting, wittingly

example, allowing the entry of Wal-Mart and other big retailers which would enable small farmers to access foreign markets more effectively and bring wider benefits.

*What are the obstacles to good policy in India and other poor and middle-income countries?*

The obstacle to good policy in India is that any time the government tries to add to the reforms, the same set of left-leaning critics go into battle against them, all over again. This is why we have been brutally

or unwittingly, excess spending which will lead to more inflation, which will certainly harm, not help, the poor and the lower middle class. So, Sen is now guilty of a sin of commission as far as poverty reduction is concerned.

I might also add that one important difference between us is that I argue that, in countries such as India, Indonesia, Brazil

more from the advanced machines. Without the growth strategy, based on outward orientation of the economy to the world, the high levels of literacy would have amounted to a hill of beans. In arguing otherwise, I am afraid that Sen reminds me of Kevin Costner in the film, *A Field of Dreams*.

I might also cite my co-author Panagariya, who has written about



## THE CEASELESS DECLAMATIONS BY PRESIDENT OBAMA AGAINST OUTSOURCING AND AGAINST IMPORTS ARE DEPLORABLE

and China, where there are many poor and few rich, social spending (“redistribution”) is not a sensible programme for aiding the poor. Why? Because, as the famous Polish economist Kaleci told me in 1961/62 when I was working on poverty reduction in the Indian Planning Commission, “Bhagwati: India has too many exploited and too few exploiters”. Even if you expropriated or taxed away the incomes at the top, and used the money to help the poor, you could give them maybe one more chapatti a day; and that too would not be sustainable if the population grew. So, my solution was that we should grow and that growth would generate the revenues which then could be spent on health, education etc. for the poor.

Sen has occasionally argued as if the added chapatti a day would produce growth and hence the revenues for further social spending. Yes, sometimes you can have your cake and eat it. But Sen has never produced any empirical argument to support this euphoric claim!

Instead he has also claimed that education would have a great payoff in terms of growth (for example, in his letter to *The Economist* where he attacks me angrily for misrepresenting him). He invokes Singapore. But the high level of literacy inherited from the Japanese would in itself have led to little in that country. It was the export-oriented growth that led to embodied technology being imported and the high literacy made it possible to gain

South Korea. He notes that there was a massive increase in literacy from very low rates to 84.5 per cent for males and more than 85 per cent for females by 1966. Yet during this expansion of literacy, growth was modest. For example, from 1954-62 it was just 4.2 per cent. Growth accelerated only from 1963 and this was due to other changes in policy, including those that led to a massive increase in labour-intensive exports.

Again, it is absurd to claim that India could have supported, despite the huge numbers of our poor, the level of expenditure on education in the early years that we could afford much later only after growth had occurred and revenues had been increased. Panagariya has produced the telling calculation that it would have taken a whopping 22 per cent of GDP in 1950-51 to reach the current, post-reforms, per capita expenditure on education!

***When it comes to trade, how can the West reform policy in a way that would benefit both Western consumers and the world's poorest people?***

Developed countries should keep their markets open. This is where the ceaseless declamations by President Obama against outsourcing and against imports are deplorable: that is not leadership. In fact, he sounds exactly like Lou Dobbs, now not in his CNN job, who used to talk in much the same way; but what Lou Dobbs said mattered less because he was not the US President and he did not have the mellifluous voice of President Obama!•

